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UNCLAS SECTION 01 OF 02 TEGUCIGALPA 002110

SIPDIS

FOR DS/OFM/VTC/TC - W. NEMETH

INFO WHA/EX/PMO AND WHA/CEN

E.O. 12958: N/A
TAGS: OFDP AMGT HO
SUBJECT: EMBASSY TEGUCIGALPA MAY LOSE GASOLINE TAX EXEMPTION

¶1. This is an action request -- see paragraph 7 below.

¶2. SUMMARY: Honduran tax law changes jeopardize the tax relief Tegucigalpa currently enjoys with respect to gasoline purchases. The U.S. Mission may soon lose its current gasoline tax exemption, a discount of about 40 percent from the price paid by regular customers without tax-free status. We request OFM's guidance on how best to prevent the loss of this benefit, an annual cost difference of over 90,000 dollars per year for official and personal purchases. This message supplements a separate, more general cable on bilateral sales tax issues. END SUMMARY

¶3. A special relationship: By buying in bulk, Embassy Tegucigalpa has always been able to purchase duty-free gasoline for its official vehicles. In 1999 we negotiated a special procedure with the government of Honduras and Texaco, whereby three different types of taxes and import duties were waived for individual purchases at two local gas stations. The customer presents a special Embassy-generated discount card and all three gasoline taxes are discounted at point-of-sale. The current price paid for official and personal gasoline purchases is 28 Lempiras per gallon (about 1.60 U.S. dollars), a savings of 40 percent over the regular retail price of 46 Lempiras (2.64 U.S. dollars). We are one of only two diplomatic missions that receive tax-free gasoline, mostly because the U.S. Mission's buying power makes it worthwhile for companies like Texaco to do the associated tax exemption paperwork. Since gasoline taxes are levied under a separate law, unrelated to the regular sales tax, our gasoline discount remained in place despite last summer's tightening of Honduran sale tax laws.

¶4. Historical background: The Honduran government has traditionally granted the U.S. Mission gasoline tax exemptions on consumption taxes as well as import duties. A value-added tax known as "Fondo Compensatorio de Subsidios" (Subsidy Compensation Fund) was not exempted for the U.S. Mission until 1995. Relief from this tax was granted annually as a special consideration to the U.S. Mission, rather than an obligation under international law. In 1998, a government decree converted this tax into the "Aporte para la Atencin de Programas Sociales y Conservacin del Patrimonio Vial" (Contribution for Social Programs and National Highway Conservation), establishing its rate at US 0.80 per gallon. This surcharge is part of the present formula used to determine the cost of gasoline and one of the three types of taxes from which the U.S. Mission has been exempt since 1999.

¶5. Others want in: The Honduran government has been
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under increasing pressure to offer duty-free gasoline to other foreign missions. Last year's tax law changes, followed by substantial increases in the local bureaucratic requirements for sales tax relief, prompted other missions to begin looking for tax advantages similar to those enjoyed by the U.S. Mission. A separate message describes other effects of the June 2002 tax law changes on the U.S. Mission.

¶6. The Honduran perspective: A portion of this tax was, in fact, a sales tax, and all of it was ad valorem. It was changed to an indirect tax in April, 2003, as an intentional policy to flatten out the income stream and stabilize government revenues. Honduras is not the only country in the world that taxes gasoline heavily. The gasoline tax is part of the Honduran government's efforts to balance its budget and qualify for an IMF program.

¶7. The crackdown: On June 9th of this year, the Ministry of Foreign Affairs sent a diplomatic note to the Dean of the Diplomatic Corps clarifying the Honduran government's present policy on duty-free fuel products. Honduras recently abolished all other consumption and import taxes on fuel products, at the same time raising

the "Patrimonio Vial" to over 1.05 dollars per gallon, about 40 percent of the retail cost of gasoline. The June note stated that this was an indirect, value-added tax and thus no further exemptions would be allowed. The Ministry cited Article 34 of the Vienna Convention, stating that a diplomatic agent shall be exempt from all taxes and duties except indirect taxes that are normally incorporated in the price of goods or services. Ministry officials have verbally informed the Embassy that this interpretation precludes any continuation of tax relief on gasoline for the U.S. Mission, at least after our current bulk purchase permit expires in early March,
¶2004.

¶8. If it walks like a duck... Tegucigalpa believes any tax that can be easily identified and quantified is a direct tax within the meaning of the Vienna Convention. We understand that there are highway repair fund surcharges incorporated into the cost of gasoline in the United States. But we also understand that these user fees are only a fraction of overall U.S. fuel costs, as opposed to the 40 percent "Patrimonio Vial" in Honduras. We also find it highly coincidental that this surcharge was raised just as other taxes were being eliminated, conveniently allowing the same revenue stream to the GOH but under the guise of a user fee or indirect tax.

¶9. Guidance requested: Tegucigalpa needs to develop an effective strategy for preventing the elimination of fuel tax exemptions by the Honduran government. Our current bulk exemption expires in early March. Please provide talking points, diplomatic note language and other guidance, backed, if needed, by reciprocal tax treatment of the Honduran mission in Washington. Many thanks.

Palmer